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MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

Monetary Policy: Steady As She Goes

Despite widespread expectations that the Federal Reserve was on the threshold of a decided easing of monetary policy, it now appears that hope outdistanced reality in recent weeks, and that a substantial loosening of the credit reins, if it occurs at all, may be months away. Although Fed Chairman Alan Greenspan did acknowledge in last week's Congressional testimony that the central bank had eased policy slightly "a few weeks ago", additional steps in this direction anytime soon seem unlikely. This is because the Fed remains convinced, as the Fed Chairman also stated, that the economy will grow at a moderate clip this year. Also, nagging doubts persist as to both just how subdued inflation expectations really are and how permanent the dollar's new-found stability actually is. Thus, monetary policy is unlikely to change in any direction—until such time, of course, as either clearer evidence of an economic slowdown prompts a shift toward greater ease, or a pickup in the rate of inflation causes the opposite.

With monetary policy currently in a holding pattern, speculation among the "Fed-watchers" now centers on what the central bank's next move will be—and when. But, determining whether the economy is soon going to slow sufficiently to prompt greater ease, or whether a rebounding inflation rate will produce more restraint, is no easy task. As is often the case, but perhaps more so since the stock market plunge of last October, no clear consensus exists as to whether the economy is poised to expand, contract or just tread water for a while. What is more, the latest economic statistics don't help much; they paint a mixed picture, at best.

For example, although the unemployment rate held steady in January at an 8½ year low, the rate of jobs growth slowed. And while big-ticket, durable goods orders in January suffered their largest one-month drop in a year, new orders for nondefense capital goods, a barometer of future plant and equipment spending, posted a good-sized gain. Automobile sales have been bouncing higher in recent weeks, but housing starts and new home sales have tumbled. And, while the estimate of inflation-adjusted gross national product growth in the fourth quarter of last year has been revised higher, the fact remains that a hefty portion of the GNP gain still stems from a large buildup of inventories—doing little to dampen fears that a pronounced inventory correction could lead the economy into a recession.

Economic and Price Trends Suggest Caution

While the recent consumer spending, housing and inventory statistics suggest generally weaker business conditions in the months ahead, possibly justifying a switch toward greater ease, there are still several clear-cut sources of economic strength which tend to diminish the urgency of such a move. For one thing, exports are still growing at a healthy clip, measured in both current dollar and volume terms, a trend which at long last promises a narrower trade deficit and better times ahead for industrial America. For another, sizzling export sales have helped push utilization rates in the manufacturing sector to their highest levels in eight years.

This, in turn, has put pressure on firms in a wide variety of industries to step up capital spending, despite the fact that domestic demand conditions are less than robust. However, as the sources of growth shift from consumer and government spending to exports and business capital spending, which are smaller segments of the economy, it would be highly unusual if the pace of business did not decelerate. Thus, the Fed's decision to keep its policy stance steady is a clear gamble that today's slower growth is a sign of the emergence of a better-balanced business expansion, rather than the precursor of a recession.

The principal explanation for the Fed's hesitancy to ease is a concern that if the degree of weakness in the economy is overestimated, and credit conditions are overtly eased, the mistake could be a big one: It could touch off a renewed upturn in the rate of inflation. As Chairman Greenspan pointed out in his Congressional testimony, at current levels of resource utilization and with import prices rising due to past dollar declines in the foreign exchange markets

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"vigilance against signs of a re-emergence of greater inflationary pressures will continue to be needed". What is more, the 0.4 percent month-over-month advance in January's Producer Price Index is hardly reassuring – it brought to nearly six percent the rate of producer price inflation over the past year, excluding changes in the volatile food and energy components. And on this basis, January's Consumer Price Index rose a hefty 0.5 percent – a six percent annual rate!

The Money Supply May Justify More Ease

With sizable segments of the economy and the rate of inflation exhibiting a fair degree of buoyancy, expectations of an easier monetary policy appear dashed. But are they? For the optimists who still long for a decided loosening of the money reins, even in the absence of signs of a pronounced business downturn, there is a ray of hope. It is the money supply, and the recent decision by the Fed to release the M2 and M3 numbers weekly. Although the financial markets have tended to ignore the monetary aggregates ever since the Fed divorced policy actions from the weekly M1 money trends, the decision to release the

Short Term Paper Outstanding
(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/10/88)	182,699	+ 1,218	+ 15,699
New York City (2/17/88)	38,517	+ 60	+ 1,743
Commercial Paper (2/17/88)	387,030	+ 1,278	+ 49,723

Bank Loans
(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/10/88)	289,475	– 197	– 5,698
New York City (2/17/88)	56,099	+ 418	– 9,790

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/10/88)	867,622	– 1,611	+26,655
New York City (2/17/88)	172,561	– 1,931	–33,086

Financial Markets

	Friday 2/26/88	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.75%	– .08	+ .18
180-Day Bills†	6.02	– .21	+ .37
Longest Bills†	6.59	– .06	+ .74
Recent Issues:			
7 1/8S 2/28/90 (When Issued)	7.11	NA	
8 1/4S 12/31/91	7.50	– .05	
8 1/8S 2/15/98	8.17	– .08	
8 7/8S 8/15/17	8.37	– .07	
Municipals:			
Bond Buyer–20 Bond Index* (2/25/88)	7.52%	– .03	+ .93
Blue List Total ($ Million)	$1,205	– $173	–$ 811
30-Day Visible Supply ($ Million)	$1,464	+ $105	–$2,866
Total	$2,669	– $ 68	–$3,677
Corporates:			
Moody's Aa Composite (2/25/88)	9.53%	– .07	+ .68
30-Day Visible Supply ($ Million)	$1,307	– $ 52	–$1,652
Stocks:			
Dow-Jones Averages:			
Industrials	2,023.21	+ 8.62	–200.78
Transportation	826.36	+ 10.82	–109.32
Utilities	182.36	– 2.21	– 36.61
65 Stocks	756.38	+ 3.33	– 92.84
N.Y.S.E. Composite Index	147.70	+ .74	– 14.31
N.Y.S.E. Avg. Daily Vol. for Week (000's)	161,714	+ 30,531	+28,718

*34% Taxable equivalent 11.39%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 2/26/88	Week Ago
Overnight	6.38%	6.56%
1 month	6.69	6.68
3 month	6.69	6.75
6 month	6.81	6.88
1 year	7.13	7.19
EURODOLLAR BONDS Average Yield		
Medium Term (5 yrs.)	9.18%	9.18%
Long Term (10 yrs.)	10.12	10.12

FOREIGN EXCHANGE SPOT RATES

New York Opening (2/26/88)	Currency Per U.S. $	Week Ago
Canada	1.2632	1.2716
France	5.7140	5.7685
Germany	1.6885	1.7060
Italy	1244.00	1256.25
Japan	128.27	130.00
Mexico	2267.00	2243.00
Switzerland	1.3890	1.3983
U.K.*	1.7725	1.7495

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (2/26/88) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.4%	–5.2%

broader money figures on a weekly basis may re-focus market attention on money growth rates, target ranges and their policy implications.

At this time, the year-to-date growth of M2 -the Fed's most important money measure -stands right around the midpoint of this year's four-to-eight percent growth target range. However, this comes on the heels of a substantial undershoot of 1987's growth target. Over the balance of this year, M2 could expand by better than 8½ percent and still not exceed this year's upper target boundary. By again drawing the market's attention to the money supply, and the fact that its expansion has been generally more subdued than desired, the Fed could be laying the groundwork for additional monetary stimulus, regardless of trends in the upcoming business and price statistics. If so, Fed policy decisions would no longer be keyed solely to the usual, inconclusive economic statistics. What is more, by citing the need to stimulate flagging money growth, the central bank would have a ready rejoinder to any criticism that it is playing election year economics. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 2/24/88	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	223.300	+ 3.290	+22.207
Loans to Depository Inst.	.340	– .169	– .274
Float	.642	– 3.282	+ .098
Total Reserve Bank Credit	238.420	– 1.319	+19.353
Treasury Deposits with Federal Reserve Banks	4.111	+ .686	– .097
Currency in Circulation	224.506	– .536	+18.049
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	220.601	+ 4.548	+52.253
	2/24/88		
Member Bank Reserves:			
Total Reserves Held	57.444	– .765	– 1.804
Excess (Deficiency)	1.060	– .246	– .009
Net Free Reserves	.867	– .296	+ .178

Monetary Aggregates †		% Change Since 3 Months Ago‡*	% Change Since Year Ago
M1 (2/15/88)	759.9	+ 2.7	+ 3.4‡
M2 (2/15/88)	2,945.7	+ 5.6	+ 3.4**
M3 (2/15/88)	3,722.7	+ 5.5	+ 5.0**
Domestic Nonfinancial Debt (3rd Q'87)	8,139.1	+ 7.6	+ 10.0

† Seasonally adjusted.
‡ Four-week moving average.
* Seasonally adjusted annual rate.
** Based on monthly data.

New York Money Market

Offering Rates 2/26/88	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	5.60%	5.78%	6.22%
* Federal Agencies	6.30	6.32	6.40
* Municipal Notes—High Grade (34% Taxable Equivalent)	6.67	6.82	7.20
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	6.60	6.70	7.00

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	6.38%	Mar.	6.50%
15- 29 days	6.45	Apr.	6.50
30- 59 days	6.45	May	6.50
60- 89 days	6.50	Jun.	6.50
90-179 days	6.50	Jul.	6.50
180-239 days	6.40	Aug.	6.50
240-270 days	6.40		

‡Industrial Paper—Prime			
30- 89 days	6.50%	†Federal Funds	
90-120 days	6.55	Effective Rate	6.55%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'87	$ 4,604r	$ 4,524	$ 4,288
Gross National Product (1982 Dollars)*	4th Q'87	$ 3,878r	$ 3,836	$ 3,732
Percent Change, Annual Rate	4th Q'87	4.5r	4.3	1.5
Change in Consumer Prices*	Jan '88n	3.6%	2.4%r	8.4%
Change in Producer Prices*	Jan '88n	4.8%	– 4.8%r	6.0%r
Civilian Employment (Thousands of Persons)†	Jan '88	114,129	113,744	111,014
Unemployment as % of Civilian Labor Force†	Jan '88	5.8%	5.8%	6.7%
Personal Income*	Jan '88n	$ 3,879	$ 3,866r	$ 3,632
Leading Indicators Composite Index (1967=100)†	Dec '87	190.7	191.0	186.7
Industrial Production Index (1977=100) †	Jan '88n	133.8	133.6r	126.2
Net Change in Consumer Installment Credit †	Dec '87	$ 4.45	$ 2.63	$ 0.14
U.S. Merchandise Trade Balance	Dec '87n	–$ 12.20	–$ 13.22	–$ 10.66
Plant and Equipment Expenditures*	1st Q'88	$427.97(a)	$417.25(a)	$374.23
Private Housing Starts (Thousands of Units)*	Jan '88n	1,377	1,404r	1,804r
New Construction Expenditures*	Dec '87	$ 409.7	$ 411.3	$ 380.2
Total Business Inventories †	Dec '87n	$ 701.9	$ 696.4r	$ 652.6r
Total Business Sales †	Dec '87n	$ 466.6	$ 460.6r	$ 443.6r

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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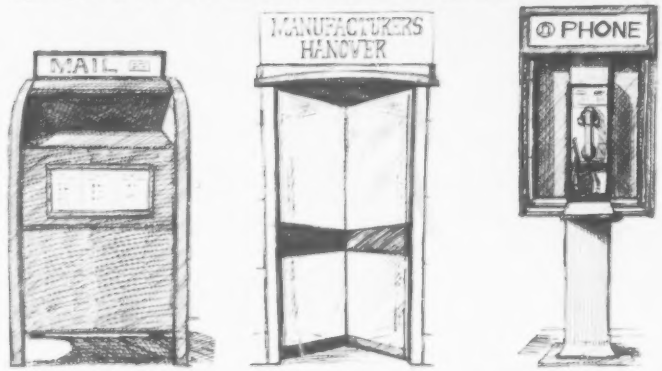

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